BANKING REFORM IN THE UNITED STATES

ADDRESS

OF

NELSON W. ALDRICH

BEFORE THE

ACADEMY OF POLITICAL SCIENCE

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NOTE TO SECOND EDITION.

Since the following address was read before the Academy of Political Science, the "Federal Reserve act" has become a law. The Senate and the Democratic caucus practically remodeled the measure, eliminating many of the objectionable features of the House bill, and modifying provisions which had been subjected to severe criticism. The act as finally adopted will, I believe, be accepted by the national banks with a view of seeking in good faith to make its operation a practical success and with the hope that defects may be cured by subsequent legislation.

Whether the measure will meet the expectation of its friends will depend largely upon the manner in which it is administered. Its success will depend, first of all, upon the character and wisdom of the Federal Reserve Board, which is granted extraordinary powers of control over vast interests and intrusted with the decision of the intricate questions which are involved in the various provisions of the act. Very much will also depend upon the conservative character of the management of the several Federal Reserve banks.

The act adopts many of the principles of the bill reported by the National Monetary Commission, as will be seen by a comparison of the texts of the two measures. Its authors concede that effective legislation for banking reform must embody provisions for the concentration and mobilization of bank reserves through an organization of banks, and that member banks must be able through such an organization to maintain and replenish their reserves by a rediscount of commercial paper. Whether the organizations provided by the act will secure these results in a satisfactory manner can be ascertained only by experience.

If the loaning and note issuing power of the reserve banks is used to the fullest extent in ordinary times as anticipated by some of the authors of the act, these institutions will be found powerless in case of emergency for purposes of support or protection. The adoption of this policy would naturally lead to an expansion of credit and inflation of the currency, producing an appearance of prosperity and a boom in speculative prices, but the ultimate result would be disastrous.

N. W. A.

Warwick, January, 1914.

BANKING REFORM IN THE UNITED STATES.

Any intelligent criticism of legislative proposals for banking and monetary reform must be based on a knowledge of existing conditions and of the present and prospective needs of the country, and a clear understanding of the defects to be cured and the evils to be avoided, as well as the nature of the remedies to be adopted. The magnitude of the interests to be affected favorably or unfavorably by suggested changes should lead us to exercise the greatest care in the formation of our judgments, and to see to it that we are not influenced in our opinions by local or other prejudices. Statistics are available to show the extent of the banking interests directly affected by monetary legislation, but we cannot possibly measure the magnitude of the interests which the American people of every community, of every section, have in the wisdom or unwisdom of suggested changes. The number of stockholders and depositors in, and borrowers from our banking institutions is greater than that of the adult population of the country. The people who have the deepest direct interest in the efficiency and good management of our financial institutions are the active business men throughout the country, whose enterprise has earned for the United States the first place in the world of industry and commerce. The people who will suffer most from injurious changes will be the wage earners and the great mass of people engaged in productive industries.

CHARACTER AND MAGNITUDE OF OUR BANKING SYSTEM.

The current report of the Comptroller of the Currency shows that we have in the United States approximately 29,000 state

and national banks (about 22,000 state and 7,000 national), with resources in excess of 25,000 millions of dollars. The rapid growth of our banking facilities in recent years is shown by increases from 1900 to 1912, in the number of institutions, from about 13,500 to 29,000; in banking resources from 10,785 million dollars to 24,986 millions; in loans and discounts from 5,657 millions to 13,953 millions; in individual deposits from 7,239 millions to 17,024 millions. The increase in population between 1900 and 1912 was twenty-two per cent, while the increase in banking resources was one hundred fifty-eight per cent. The wise management of these banks, for in the main the management has been wise, and the judicious use of these enormous banking resources have been perhaps the most important factors in promoting the growth and securing the unexampled prosperity of our agricultural, commercial, and industrial interests in recent years.

Every community in the United States, large or small, has one or more banks. The managers of these banks are men familiar with the wants of their customers and they are usually accepted as the financial advisers of their neighbors. In all matters affecting the prosperity of the neighborhood in which they are located their advice and judgment are often sought and usually followed. The intimate and important relations existing between banks and bankers and the people and communities should be carefully considered in any examination of the provisions of suggested legislation.

GENERAL CONDITIONS DEMAND REFORM.

The exceptional record of the successful growth of our banking interests to which I have referred has been coincident with the unexampled prosperity of the country. We must not,

however, lose sight of the fact that our great banking resources have been found in serious emergencies powerless to avert general disaster. Our banking system has broken down when subjected to any very severe strain. While there is nothing in present or prospective business conditions that should occasion alarm, we must remember that financial troubles often, in fact usually, come unheralded. Even the causes that produce them even can never be definitely stated. It is evident that in the near future the adequacy of our banking facilities is to be tested by new demands for credit in addition to our normal business requirements. In magnitude, unusual demands at home and abroad for additional credit and for the placing of new loans by states and industrial organizations have never been equaled. Demands of this nature, world-wide in extent, impose new and greater burdens upon the banking resources of the world. With the close business and financial relations which modern conditions have established between the great commercial nations, each country must bear some share of these new responsibilities. The need of the states of the near East to fund indebtedness contracted during the late conflict and to enable them to repair the ravages of war adds largely to the usual European demand.

In Europe, fear that grave political problems may not always be found capable of peaceful solution, and dread of the evil effects of an undue expansion of credit in some quarter, are disturbing elements. The high rates demanded for government and other loans, the impossibility of floating long-time loans at any rate, are evidences of unsettled and unsatisfactory conditions in the world's money markets. In the United States our financial institutions will be called upon to meet insistent requirements of steam and electric railroads and industrial corporations for new loans to pay for necessary improvements

and extensions, and to refund maturing obligations. Government and other large borrowers will be obliged to pay rates which a few years ago would have been considered extortionate. The effect of recent tariff legislation on business and government revenues is yet unknown. These conditions taken together naturally create a feeling of uncertainty in all financial centres. The enormous shrinkage, amounting to thousands of millions of dollars, which has recently taken place in the value of securities and property in the United States, furnishes evidence, whatever may be the cause, of a want of confidence in our continued prosperity on the scale of our past achievements.

These among other considerations should lead us to exercise the greatest care in the selection of remedies for admitted defects in our banking system. The people of this great country, with all the momentous consequences involved, cannot afford to venture on untried experiments, or to adopt principles or methods that have been rejected by the teachings of universal experience. We cannot measure the direful results which might follow revolutionary changes. Any remedial legislation should be constructive and not destructive. We should seek to strengthen rather than weaken the efficiency of our credit organization. We should supplement rather than supplant a system which has grown to such enormous proportions under state and national laws, and to which the business of the country has with more or less satisfactory results become adjusted.

CHARACTER OF THE REFORM DEMANDED.

To secure a wise and comprehensive reform of our banking and monetary system, we require:

1. An efficient banking organization by which bank suspensions and financial crises with their evil results can be avoided.

2. Means to secure a concentration of cash reserves of the banks and their mobilization for use whenever and wherever needed in times of trouble. In times of stress, scattered reserves of banks have been found useless, either for defense or protection. The scramble of 25,000 banks in 1907, each to take care of its own interests and to increase its own cash reserves, contributed very largely to the panicky conditions which led to general disaster. Banks must be furnished with effective means for replenishing their reserves and increasing their loaning power at times when the need for credit expansion is imperative.

3. The general coöperation of banks must be secured to protect their own or the public interests when these are menaced and when individual or local efforts are ineffectual to prevent the paralysis of business and domestic exchanges.

4. An organization must be provided that can deal effectively with conditions which imperil the credit and status of the United States as one of the great financial powers of the world. In times of threatened trouble or actual panic, the power to control the movements of gold and the course of foreign exchange through raising the rates of discount or otherwise is essential, from both a national and an international standpoint.

5. We must have an organization whose influence can be made effective by an advance in discount rates or otherwise in preventing an undue expansion or dangerous inflation of bank credits.

6. A currency should be provided that, in character and volume, in contraction as well as in expansion, will be responsive to normal or unusual demands. Seasonal or unusual

demands for currency or credit for crop moving or other purposes have at times produced very unsatisfactory conditions in the money market owing to the inelastic and unscientific character of our monetary system.

7. A broad discount market must be created with recognized and legalized standards of commerical paper. Recent conditions also impose unnecessary burdens upon business and production, and hinder the natural development of certain sections of the country. These evil results are felt more keenly in new and undeveloped communities. The lack of such a discount market leads banks in all sections to send surplus money to New York to be loaned there on stock exchange securities.

The methods necessarily used in raising the enormous sums required for the production, movement, and marketing of our agricultural and other products, are crude and unnecessarily expensive to producers. Notes and bills of exchange issued or drawn for agricultural, commercial, or industrial purposes, can be discounted only in a narrow, local market, and the result has been that our farmers and all others engaged in productive industries have been obliged to pay higher rates for their loans and have been placed at a great disadvantage in securing the credit which they have required and to which they are fairly entitled, for the growth, retention, and distribution of their products. The adoption and use of proper standards for such commercial paper would enable our banks profitably to replace in their portfolios speculative low-rate loans of all kinds with notes, bills of exchange, and acceptances, based on the products and property of the country. If this change can be made, it will prevent the dangerous congestion which takes place at times in the great financial centres. It is difficult to understand, in this connection, why national banks, which are authorized by the House bill to accept drafts

growing out of transactions involving importation or exportation of goods, are not permitted to accept domestic drafts of the same character. Why should a bank in Mississippi or Texas be permitted to accept the draft of a cotton planter on Liverpool, based on cotton shipments, when it could not accept the drafts of the same planter on a domestic consumer? Why should an importer in New York have better facilities than the western farmer who ships his grain to an eastern market?

EFFECTIVE REMEDIES SUGGESTED BY EUROPEAN EXPERIENCE.

While there seems to be a general agreement as to the nature of the reforms demanded, unfortunately there is no such consensus of opinon as to the methods and machinery which should be employed in securing the desired results. This is to be regretted, as it seems certain from the experience of other nations that simple and effective remedies for defects are easily within our reach. While we have suffered greatly in almost every decade of our history from the evil effects of financial crises, the people of the great commercial countries of Europe have been entirely free for nearly half a century from disastrous losses arising from this cause. This exemption may be said to be due solely to the character and efficacy of their credit and banking organization. The experience of England and France, and later of Germany, in this respect, has led all the important commercial nations of the world except the United States to follow, in the essential features of their credit organization, in the foot-steps of these great countries. The adoption within a few years by Sweden, Switzerland, and Japan of banking organizations along the lines of the countries I have referred to, completes the adherence of the commercial world, outside of this country, to one general banking and monetary policy.

CRITICISM OF THE BILL.

In considering the character of the remedies proposed by the bill which recently passed the House of Representatives I am not unmindful of the fact that it is much easier to criticise than to construct, and I certainly do not intend by any criticism I may make to increase the difficulties of legislators charged with serious responsibilities, but rather to call attention to changes which, it seems to me, must be made in the plan in the interest of wise and permanent legislation. The authors of the bill having in a majority of cases accepted remedies of the character I have suggested and adopted ideas based on experience of other countries, and on sound economic principles, it is all the more to be regretted that in some of the most important provisions of the bill the lessons of experience have been ignored.

My suggestions with reference to certain provisions of the bill are made with the hope that they may prove of service to those who have the bill in charge, in their difficult task of perfecting the measure. It is certainly desirable that the American people, whose highest interests are to be affected favorably or unfavorably by congressional action, should have as clear an understanding as possible of the nature of the proposals.

The two features of the bill which are open to the most serious objection are, first, the provisions which authorize the issue of government notes to be circulated as money and loaned on collateral security to the federal reserve banks created by the bill; second, the provisions which create a government board which can be accurately described as a government central bank of an objectionable type.

NOTE ISSUES.

The proposals with reference to note issue are radical and revolutionary in their character and at variance with all the accepted canons of economic law.

It can hardly be necessary for me to recount in this presence the disastrous results which have inevitably followed the issue of paper money by governments or states. I need only remind you of our own colonial and continental experiences. That of France at the time of John Law and the French Revolution is equally significant. In exceptional cases, like our own experience with United States notes, where continuous depreciation has not ended in absolute worthlessness of issues, the losses arising from the use of a depreciated currency have greatly exceeded any possible financial benefits which have resulted from the violation of economic laws. Competent authorities estimate the greater cost of our civil war, owing to the use of depreciated currency, at more than five hundred millions of dollars.

In all cases of government issues, when the resulting expansion and inflation have brought about instability of conditions and values, those dependent upon wages and salaries and those engaged in agricultural and other production have been the principal sufferers, while the capitalists and speculators who could take advantage of constantly changing conditions have been the only classes who have been benefited. This condition has never been better characterized than by Daniel Webster, who said:

"Of all the contrivances for cheating the laboring classes of mankind, none is so effectual as that which deludes them with paper money. It is the most perfect expedient ever invented for fertilizing the rich man's fields by the sweat of the

poor man's brow. Ordinary tyranny, oppression, excessive taxation, these bear lightly on the happiness of the community compared with fraudulent currencies and the robberies committed by depreciated paper. Our own history has recorded enough, and more than enough, of the demoralizing tendency, the injustice and intolerable oppression on the virtuous and well-disposed, of a degraded paper currency, authorized by law, or in any way countenanced by Government."*

Peletiah Webster, writing in 1781, after the total volume of Continental paper money had become worthless, said:

"We have suffered more from this than from any other cause or calamity. It has killed more men, pervaded and corrupted the choicest interests of our country more, and done more injustice than even the arms and artifices of our enemies."†

Leading enconomists, financiers and statesmen of every shade of political belief have joined in the condemnation of the use of the obligations or notes of governments as a circulating medium. On this subject the views of Alexander Hamilton who believed in a centralized national government, were fully concurred in by General Jackson and Mr. Benton and the leading statesmen who represented opposite views of government and of currency and banking questions.

Mr. Hamilton said in his report of 1790:

"The emitting of paper money by the authority of Government is wisely prohibited to the individual States by the national constitution, and the spirit of that prohibition ought not to be disregarded by the Government of the United States. Though paper emissions, under a general authority, might have some advantages not applicable, and be free from some disadvantages which are applicable to the like emissions by the

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*Congressional Globe, 27th Cong., 2d sess., app., p. 65.

†Horace White, Money and Banking, 4th ed., p. 92.

states, separately, yet they are of a nature so liable to abuse—and, it may even be affirmed, so certain of being abused—that the wisdom of the Government will be shown, in never trusting itself with the use of so seducing and dangerous an experiment."

I will quote the views of General Jackson and Mr. Benton later.

Among American economists, the position and authority of Professor C. F. Dunbar will not be questioned. I know of no political economist of standing in this country who will not agree that the following statement of Professor Dunbar sets forth the sound economic doctrines that should control our note issues:

"The necessary conclusion from our experience with the legal tender notes plainly is that a government currency, under our conditions, is an unfit subject for national legislation. * * * * * *

"The often-repeated argument that a government issue, being a loan without interest, results in a saving to the treasury which is lost when the right of circulation is delegated to banks, is frequently resorted to. The experience of the United States presents a complete answer to this penny-wise reasoning. * * * The people of the United States have lost by shaken confidence, discouraged enterprise, and the actual ruin of thousands of citizens, resulting from the mismanagement of their currency, an amount beyond all comparison with the annual saving made by them at the treasury. * * *

"Errors made in the past will be also made by the new men in the future; and the possibility that, in any moment of popular discouragement or passing delusion, some fresh experiment or abandonment of wholesome limitation may be resolved upon in haste, but with irreparable results, must continue to be a standing menace to our credit, public and private. * * *

"Experience has shown that we can rely upon no principle or policy as a safeguard against the caprice or the temptation which at intervals must surely beset any legislative body having control of the direct issue of paper."*

Among British economists, Mr. H. D. Macleod is perhaps the leading authority on banking and currency questions, and the view he expresses in the following quotation would be universally acquiesced in by foreign political economists. He says:

"Governments and states should never issue paper money themselves. When states and governments once begin to issue paper money, they can never resist the temptation to issue it in boundless quantities, so that it soon begins to depreciate. They have no power to redeem it: and the depreciation is incurable."†

Citations of a similar character could readily be made from the opinions of all leading authorities, from the public utterances of statesmen, from the views of the representatives of all parties and of all classes.

Note issues in all commercial nations are made through banks of issue created by the government; all the conditions of issue, including those relating to character and amount are fixed by government. This method of note issue finds universal approval in all enlightened countries.

In the thorough reëxamination of banking and monetary questions which has recently taken place in Germany, Switzerland and elsewhere, no representative of any party and no individual appeared to favor the substitution of government notes for bank issues.

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*C. F. Dunbar, Economic Essays, pp. 219, 225-7.

†H. D. MacLeod, Theory of Credit, v. 2, pt. 2, p. 1105.

It is true that in the period from 1814 to 1861, Congress authorized the issue of treasury notes in limited amounts, which were in every case issued as evidences of indebtedness on account of money borrowed to meet deficiencies in revenue or expenses growing out of wars. These treasury notes were receivable for public dues and were, with few exceptions, payable at a fixed time with interest, and were usually in denominations that precluded their use as currency.

The power given Congress by the constitution to borrow money clearly involved the right of issue of securities of such character and in such form as Congress might determine, and the right of the Government to issue obligations of this nature was not seriously questioned in any quarter. Our own experience prior to the adoption of the constitution led the framers of that instrument to expressly forbid the states from emitting bills of credit, and the doctrine that the issue of notes of the government of the United States for circulation as money was not authorized by the constitution, found wide acceptance.

The opinion of Professor Woodrow Wilson was that generally held by statesmen of the period. In his history of the United States, he says:

"It (the constitution) absolutely forbade the states to issue bills of credit, did not give the federal government power to do so, and was meant practically to prohibit the use of any currency which was not at least based directly upon gold and silver."*

The first issues of United States notes with full legal-tender qualities and intended to circulate as money were made during the civil war and grew out of the urgent necessities of the government at that time. The plea of necessity was the only justification urged for this radical departure from the policies and doctrines of the founders of the republic. Excessive issues

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*Woodrow Wilson, History of the American People, v. 4, p. 46.

of these notes and the repeal of the right to exchange the notes for interest-bearing obligations of the United States produced the usual result of depreciation and discredit.

The reasons for the general condemnation of government note issues are not difficult to understand. No government has yet been found strong enough to resist the pressure for enlarged issues in times of real or imaginary stress, or to meet some real or fancied exigency in its own affairs, or a popular demand for more money. Issues have been at first limited in amount and surrounded by proper safeguards as to exchangeability and convertibility, and by what seemed to be ample provisions for ultimate safety, but experience has shown that in every case in response to a popular demand these safeguards have been one after another ignored or removed, restrictions as to amounts of issue have been modified or repealed, and the exhiliration which has followed the initial issues has led to an irresistible demand for continuous inflation, and this has been followed by progressive depreciation, a necessary destruction of value, and general bankruptcy.

Some of the friends of the House bill who do not like to be classed as advocates of the further issue of government notes assert that the notes to be issued are after all notes of the reserve banks and that the United States occupies the same relation to them that it does to national bank notes.

The differences are, of course, perfectly obvious and fundamental. The notes to be issued by the House bill are by its express terms "obligations of the United States," issued for the purpose of "making advances to federal reserve banks," the banks to furnish "collateral" and to pay "interest" on the loans. National bank notes are in terms and in fact obligations of the national banks. The treasury under the banking law redeems national bank notes for the national banks and

takes as security for any failure of the banks to respond in payment of advances United States bonds equal in amount to the total amount of bank-note issues, with right to sell at any time at public or private sale without notice. In the one case we have obligations of the United States issued by a government agent and loaned to reserve banks. In the other case, we have obligations of the national banks with a pledge of Government bonds to secure their final redemption by the banks.

EXPERIENCE OF FRANCE.

In this connection the experience of France in 1790 and the years following with the issue of assignats furnishes valuable lessons. France had confiscated the real property of the French church, which consisted of valuable estates in town and country forming about one-third of the real property of France and having a value of about 4,000 millions of francs and yielding a yearly income of about 200 millions. The first issue of notes made in 1790 was limited to 400 millions of francs, and was based upon a specific pledge of this vast property. The holders of the notes had a right to exchange them for the property pledged at perfectly satisfactory prices. The arguments that were used in support of this issue have a familiar sound. It was contended:

"Paper money under a despotism is dangerous; it favors corruption; but in a nation constitutionally governed, which itself takes care of the emission of its notes, which determines their number and use, that danger no longer exists."*

It was claimed that paper so limited and so secured was as good as gold and that, as it could not be issued in excess, there was no possibility of depreciation. Great stress was placed upon the fact that entirely different conditions existed in Law's time, and that with a free government and new con-

*A. D. White, Fiat Money in France, p. 4.

ditions only beneficial results could follow; that prosperity and abundance were assured. A scientific, practical guarantee of goodness was asserted and in an address issued by the French Assembly it was said that the paper had no "value derived from the national authority, but a value real and immutable; a value which permits it to sustain advantageously a competition with the precious metals themselves." In the later discussions it was asserted that the precious metals would soon be used only in the arts, and a currency of paper, secured upon the first and most real of all property, would take its place. A demand was made later for an issue sufficient in amount to pay the government debt.

No paper currency ever had what seemed to be a more practical guarantee for its security and value. It was based upon what was then and is now the highest form of security, a mortgage on productive real estate of unquestioned value. The notes bore interest at a rate of three per cent. per annum and this, it was claimed, would insure their retirement when not needed. Within the next six years 36 billions of assignats and 2,500 millions of mandats had been issued, and then the collapse came, and the whole issue became worthless and was repudiated. Conditions at the end of this period are thus described by a historian of the French Revolution:

"Before the end of the year 1795 the paper money was almost exclusively in the hands of the working classes, employees, and men of small means, whose property was not large enough to invest in stores of goods or national lands. The financiers and men of large means, though they suffered terribly, were shrewd enough to put much of their property into objects of permanent value. The working classes had no such foresight, or skill, or means. On them finally came the great crushing weight of the loss."*

*Von Sybel, History of the Revolution, v. iv, pp. 337-8.

AMOUNT OF ISSUE.

I believe it will be found that there is no substantial limitation upon the amount of notes that can be issued under the House bill except in the requirements for reserve. It is claimed that the issue is limited to the amount applied for by the reserve banks, and that the aggregate amount of applications is limited by the amount of paper in the possession of the banks, and further that the central board has the discretionary power of declining applications. It is impossible to say what if any restraining effect on the volume of note issues these provisions would have. The demand for currency in increasing amounts, under ordinary circumstances, as shown by our own experience and that of other countries, is insatiable.

Selfishness is naturally a controlling factor in business corporations. We may be certain if the loan is a profitable one for the bank, applications will be made and insisted upon. If a reserve bank could hire money at ½ per cent, or 1 per cent and loan two-thirds of it to its customer at 4 per cent, 5 per cent, or 6 per cent, the business would certainly be a profitable one, and so long as the notes could be kept in circulation the amount of loans and note issues could be indefinitely increased. The power of the reserve banks to buy in the open market from private parties commercial paper and bills of exchange of individuals, firms, and corporations, and to pay for their purchases in government notes and to furnish the central board with security for the notes by a deposit of the paper purchased, provides another method of profitable note inflation.

It is certain that the central board would find it difficult to withstand insistent demands made on behalf of communities or the public. There is no limitation in the bill of the

amount of commercial paper that a reserve bank may rediscount or purchase. The amount of the loans and discounts of all the banks in the United States is about fifteen thousand million dollars and the amount of securities held by banks about five thousand millions more. The House committee fixes the amount that would be available for rediscount by the reserve banks at about six thousand millions. In my opinion this amount is likely to be largely increased by the exercise of the authority given the central board to fix the character of the loans available for rediscount.

It is, of course, problematical what portion of this vast amount could, by an insistent demand for money, or by a desire on the part of the reserve banks to increase their profits, be made available as security for loans of notes from the central board. If notes should be issued in place of national bank notes this would add seven hundred millions to any amount otherwise required. The report of the committee states that it is intended that the government notes shall take the place of national bank notes, but the bill is silent upon the subject. The commercial paper pledged by a reserve bank as the security for loans of notes is delivered to the chairman of their own board of directors and kept in his custody in a vault on their own premises. As the notes fall due, or a change is necessary for other reasons, a substitution takes place under the direction of the custodian, and, as long as the necessary amount is kept intact, the loan may go on indefinitely. It should be remembered in this connection that, by the various provisions for redemption, the notes issued to any reserve bank are returned to it by other reserve banks and by the treasury, but that there is nothing to prevent their retention and reissue by the receiving bank, and for this no new application is necessary, and the transaction can be repeated.

We may expect that the notes will become a permanent addition to the currency of the country, as currency of this character, once issued, by the operation of the Gresham law, will not be retired, and its amount will constantly increase. There will be no inducement to retire it. Each one of the federal reserve banks, by the provisions of the bill, is forbidden to pay out the notes of any other federal reserve bank, the purpose being, I suppose, to attempt to secure their prompt redemption. But this provision would not be effective, as no such prohibition applies to the twenty-five thousand other banks in the country, or to the business men and people in whose possession the notes would be found.

With extended use of the new notes, another form of currency would be added to the seven already in existence, and if the provisions in regard to the use of letters and serial numbers to distinguish notes which are to be ultimately redeemed by particular banks should give a greater value to some notes than others, as might be the case if the proposed earmarking is successful, we should have twelve additional forms of currency.

REDEMPTION OF GOVERNMENT NOTES.

The methods provided by the bill for the issue and redemption of government notes are unsatisfactory. All notes are redeemable on demand at the treasury of the United States or at any of the federal reserve banks in gold or lawful money. The banks are required to deposit with the agent of the Federal Reserve Board, with their application for notes, commercial paper and bills of exchange equal in amount to the notes applied for. Whenever any of the notes received by a federal reserve bank shall be paid out, the bank is required to segregate from its reserves, held against outstanding obligations, an amount in gold or lawful money which shall be equal

to $33\frac{1}{3}\%$ of the amount which is held for the redemption of the notes. The notes issued to any federal reserve bank are made a first lien upon all the assets of the bank.

These provisions, if effective in ordinary times when there is no call for redemption of the notes, would, I believe, fail in times of trouble. Take a condition of affairs like that in 1907 when so many of the the banks of the country suspended payment. At such a time the collateral could not be used for redemption purposes and the lien upon assets could not be enforced. The inadequate means of redemption by the reserve banks would fail to insure immediate convertibility and the treasury might be obliged to assume the entire burden. But the treasury would have no gold or other lawful money in its possession available to meet this demand, except a 5% fund. The general fund of the treasury, which includes its gold coin and bullion, would be deposited in the suspended banks, and there would be no alternative but government discredit and repudiation of its obligations.

It is said to be the purpose of the bill to consolidate reserves so that they can be made useful at any time, but in the case of reserves for note issues these would be scattered at twelve different points. Even if the reserves were consolidated and held in a manner that would permit their use they would still be found inadequate, judging by the experience of other countries.

The percentages of the average cash holdings of the three great European banks for the ten years, 1901–10, to note issues and all demand liabilities were as follows:

	England.	France.	Germany.
To note issues	86.6	84.5	72.5
To all liabilities	47.4	72.9	50.4

Convertibility of note issues should be insured by adequate cash reserves; and these should be so placed and held that they would be at all times available for redemption purposes.

It is difficult to understand why the proposition to make these new notes redeemable in lawful money, that is, in other obligations of the United States, was incorporated in the bill. Bank notes, the obligations of banks, are necessarily redeemable in lawful money, that is, in any form of money which is made legal tender by the government, but the same rule should certainly not be applied to government obligations. In colonial times it was quite common, when one issue of notes had become practically valueless, to authorize their redemption on some basis in new notes, and this process went on continuously until the final collapse of all issues.

In considering the adequacy of the reserves proposed for the redemption of the new notes I have not overlooked the fact that a provision is inserted which gives the central board the right to require the reserve banks to deposit in the treasury for redemption purposes a fund equal to 5% of the outstanding notes. There is a similar provision in the national banking law which requires a 5% fund to be deposited in the treasury, but this fund has been found for years to be entirely inadequate to meet the demands upon the treasury for redemption of national bank notes. The Secretary of the Treasury, in his last report, makes this statement:

"Redemptions of national bank notes during the year have been constantly in excess of the 5% redemption fund required under section 3 of the Act of June 20, 1874, to be kept by the banks on deposit in the treasury of the United States for the redemption of their notes. Consequently, that fund has been overdrawn during the whole year and the treasury has had to advance payment for notes as they are presented out of

the general fund. The largest overdraft was $26,900,000 on February 3, 1912."

These serious overdrafts are still going on, and in some conditions of the treasury they might cause serious embarrassment to the government. On October 1 this account was actually overdrawn, $21,760,000.

If there is to be any redemption fund held in the treasury it should be not only adequate in amount to meet ordinary demands but sufficient for all emergencies. The redemption fund provided in this bill, as well as the redemption fund for national bank notes, should be substantially increased.

EACH RESERVE BANK RESPONSIBLE FOR REDEMPTION OF TOTAL ISSUE.

Each of the federal reserve banks, notwithstanding an attempt is made to make it responsible only for notes issued to it, would be practically, and it might be actually responsible for the redemption of the total issue, as, so far as the public is concerned, all notes without distinction as to whom they are issued, are entitled to redemption at any one of the reserve banks as well as at the treasury. For instance, if a thousand millions were issued, any one of the banks would be required to redeem the whole or any part of this on demand, and this would apply to a federal reserve bank to which no notes had been issued by the board. It must be, I think, apparent, that with any considerable amount of notes outstanding, with reserves for redemption scattered in twelve different banks, any of the reserve banks or the treasury of the United States would be likely to find itself in a position where it would be unable to meet its obligations in gold or lawful money. If two hundred million dollars in these notes should be sent to the South or West for crop moving-purposes, one or two reserve

banks with $5,000,000 capital might in time of trouble be called upon to redeem notes greatly in excess of their reserves or resources.

The redemption in specie of the United States notes which were issued during the war was only possible after the accumulation of one hundred millions of gold coin procured by the sale of government bonds, and the continuous redemption is assured by the one hundred and fifty millions of gold now held in the treasury as a trust fund. We now have a proposition to issue an unknown and unlimited amount of United States notes without any government reserves of any kind.

NO SECURITY AGAINST FRAUDULENT ISSUES.

Heretofore in legislation looking to the regulation of currency or to the issue of government obligations, Congress has surrounded its authorization with every possible precaution against fraud. Issues of currency are made through the appropriate bureau of the Treasury Department, and their character and denominations are fixed by Congress itself. In the case of the pending bill, the Federal Reserve Board is authorized to issue obligations of the United States, and to fix their character, form and tenor. The transfer of this important function of government to a board whose acts are not subject to the supervision of any department of the government, with requirement for but one annual report, with no requirement for publicity of transactions, and with no power on the part of any representative of the government to detect or punish a flagrant abuse of power, has no precedent in the history of this or any other country.

If the board should prefer to substitute the notes which it has authority to issue for other forms of currency to give them a wider circulation, it might easily do so, by providing for

the issue of the new notes in small denominations of ones, twos and fives, and thus drive out of circulation and into the treasury and the banks, silver certificates and United States notes of equivalent denominations, and give this important field permanently to this new form of government currency.

RECORD OF THE DEMOCRATIC PARTY ON GOVERNMENT NOTE ISSUES.

The reasons given to justify the extreme pressure which is being brought upon Congress to enact the administration bill is that its adoption is necessary in fulfillment of promises made by the dominant party. This statement would seem to justify us in an examination of the record of the party to ascertain when and under what circumstances these promises were made. Prior to the civil war no great leader of the Democratic party advocated the issue of government notes to be used as money, as proposed in this bill. After the panic of 1873, the efforts of the friends of sound money to secure the resumption of specie payments and their insistence that the public credit could only be sustained by the payment of all government obligations according to their tenor in standard coin, led to the formation of a party which was opposed to resumption and demanded the payment of government bonds in a depreciated currency and declared for the first time in favor of the issue of United States notes in substitution for national bank notes. These opponents of resumption and the friends of further inflation and of the free coinage of silver included members of both political parties, but they were not strong enough in the early stages to induce either of the great parties to openly espouse their cause in national platforms.

The greenback sentiment was strong enough to secure the passage of an act in 1875 increasing the limit of United States notes in circulation. The veto of this measure by General Grant was an effective check to the first and only post bellum attempt prior to 1913 to secure an increased use of government money. The Democratic platform of 1872 contained an emphatic declaration in favor of a return to specie payments and a maintenance of the public credit, and denounced repudiation in every form and guise. The failure of the friends of inflation to secure the formal support of either of the great parties to their peculiar views led to the formation successively of the Greenback, People's, and Populist parties.

The first declaration in the national platform of any party in this country in favor of a further issue of United States notes was made by the Greenback convention of 1876, which declared for a United States note issue directly by the government, and convertible on demand into United States obligations.

In 1875 the Democrats of Ohio demanded that the policy of contraction should be abandoned, that the resumption law should be repealed, and that the volume of currency and United States notes should be made and kept equal to the wants of trade, and that these notes should be substituted for national bank notes. The notable campaign in Ohio in this year between William Allen and Hayes resulted in the defeat of Allen. In the following national campaign the Democrats repudiated the Ohio idea and nominated Mr. Tilden for President on a platform which declared that reform was necessary to establish a sound currency, restore the public credit, and maintain the national honor.

The Democrats in their platform of 1880 reaffirmed the declaration of 1876 and declared for honest money and strict mainte-

nance of public faith. The Greenback platform of that year declared that all money, whether metallic or paper, should be issued and its volume controlled by the government and not through or by banking corporations.

The Democratic convention of 1884, which nominated Mr. Cleveland for President, declared in favor of honest money and the gold and silver coinage of the constitution. The Democratic convention of 1888 renominated Mr. Cleveland and reënacted the provisions of the platform of 1884. The Democratic platform of 1892 demanded the repeal of the Sherman act of 1890, and demanded that all paper currency should be kept at par and redeemable in coin, "a policy made specially necessary for the protection of the farmers and laboring classes, the first and most defenseless victims of unstable money and a fluctuating currency."

The attitude of leading Democratic statesmen at that time is shown by the statement of President Cleveland in his message of August, 1893:

"The people of the United States are entitled to a sound and stable currency and to money recognized as such on every exchange and in every market of the world. Their government has no right to injure them by financial experiments opposed to the policy and practice of other civilized states, nor is it justified in permitting an exaggerated and unreasonable reliance on our national strength and ability to jeopardize the soundness of the people's money."

Similar expressions representing the views of leading representatives and statesmen of the party of the period could be readily cited.

The Democrats, in the national convention of 1896, which nominated Mr. Bryan for the presidency, announced for the first time their adherence to the doctrines enunciated by the Green-

back, Populist, and Farmers' Alliance conventions in previous years. Mr. Bryan received the nomination of the Democrats, the Populists, and the Silver party on practically identical platforms. As the advent of Mr. Bryan as the Democratic nominee marked a new era in the history of the Democratic party, and, as it was persuaded under his leadership to abandon its traditional principles, it is interesting to examine in detail the proposals of this new political combination. The Democratic platform provided:

"Congress alone has the power to coin and issue money, and President Jackson declared that this power could not be delegated to corporations or individuals. We therefore denounce the issuance of notes intended to circulate as money by national banks as in derogation of the constitution, and we demand that all paper which is made a legal tender for public and private debts, or which is receivable for dues to the United States, shall be issued by the government of the United States, and shall be redeemable in coin."

The platform in this form was reported by a majority of the platform committee, and after a long discussion was adopted by a vote of 628 to 301. The minority members of the platform committee, consisting of the representatives of sixteen States, which included such well-known Democrats as David B. Hill, of New York, William F. Vilas, of Wisconsin, Judge George Gray, of Delaware, Lynde Harrison, of Connecticut, and John E. Russell, of Massachusetts, declared that "the Democratic party is a party of hard money and is opposed to legal-tender paper money as a part of our permanent financial system." They further declared, "We therefore favor the gradual retirement and cancellation of United States notes and treasury notes under such legislative provisions as will prevent undue contraction."

The bolting Democratic convention which nominated John M. Palmer, of Illinois, for President, declared for "such intelligent currency reform as will confine the government to its legitimate functions, completely separated from the banking business, and afford to all sections of our country uniform, safe, and elastic bank currency under governmental supervision, measured in volume by the needs of business."

The Democratic platform of 1900, when Mr. Bryan was again a candidate, reënacted the currency provisions of the platform of 1896, and demanded the retirement of national bank notes as fast as government paper and silver certificates could be substituted for them.

In the Democratic convention of 1904, which nominated Judge Parker for President, there was a notable contest in the platform committee which resulted in an agreement that the platform should remain silent on all monetary questions, on the theory that these questions had been settled by legislation and events, and that there were no monetary questions at issue in the campaign. This agreement was concurred in by Mr. Bryan, but Judge Parker's telegram to a member of the convention, saying that he regarded the gold standard as affirmatively and irrevocably established, led to a prolonged discussion in which Mr. Bryan took an active part, but his ideas with reference to the government issue of notes were not adopted.

The Democratic platform of 1908, when Mr. Bryan was again a candidate, in addition to a pledge to secure legislation for a guarantee of deposits, declared, "We believe that, in so far as the needs of commerce require an emergency currency, such currency should be issued, controlled by the federal government and loaned, on adequate security, to national and state banks." The Democratic platform of 1912 was silent upon the question of government note issue.

DOCTRINE OF THE BILL.

The theory that the United States should issue currency in the form of its promises to pay is a populistic doctrine. It had no standing as a Democratic party principle until the advent of Mr. Bryan as its nominee for the presidency in 1896. It was injected by Mr. Bryan into the party platform in spite of the protests and against the votes of the men who had been most prominent in the party councils, men who advocated loyalty to the policies and principles to which the party had adhered throughout its existence. This greenback doctrine has never received the approval of the American people at the polls and there is every reason to suppose that it would today meet with their positive condemnation if the question could be submitted to a vote in a national election. It is not too much to say that the proposals in the bill came to the country as an absolute surprise. There had been no suggestion that an attempt was to be made to revive the greenback heresy or to adopt in legislation the rejected theories of the Populist party. The Democratic candidate for the presidency was silent upon the subject during the campaign and he has not, so far as I am aware, up to this time, publicly expressed his approval of Mr. Bryan's ideas with reference to note issue. The large majority of the American people who favor sound money believed that the question of further greenback issues was settled permanently by the elections of 1896 and the following years. If the House bill should be enacted into a law, Mr. Bryan will have achieved the purpose for which he has been contending for a decade. It would be difficult to find in history an occasion where a political dogma which had never found a permanent place in the tenets of the dominant party and which had been rejected by unanimous verdict of the civilized world could be successfully injected into a great legislative measure as a

price for the support of a faction. It is not surprising that Mr. Bryan should consider the insertion of his peculiar views into the measure we are considering as of transcendent importance. His views upon this subject throw such an important side-light upon this feature of the bill and the reasons for its incorporation that it seems to me desirable to quote them in full. In a recent letter to a member of the banking and currency committee of the House of Representatives, he makes the following statement:

"The provision in regard to the government issue of notes to be issued by the banks is the first triumph of the people in connection with currency legislation in a generation. It is hard to overestimate the value of this feature of the bill.

"In the second place the bill provides for government control of the issue of this money—that is, control through a board composed of government officials selected by the President with the approval of the Senate. This is another distinct triumph for the people, one without which the government issue of money would be largely a barren victory.

"The third provision of the bill, which I regard as of first importance, is the one permitting state banks to share with national banks the advantages of the currency system proposed.

"These three provisions are, to my mind, of such transcendent importance that I am relatively very little concerned as to the details of the bill."

The letter was written to a member of the House upon the eve of the Democratic caucus called to act upon the bill and amendments. While this frank and courageous declaration of Mr. Bryan's had the expected result of solidifying his followers in the support of the bill, it also, I venture to suggest, opened the eyes of that numerous portion of the American public, which is not and never has been in sympathy with his opinions

on this subject, to the dangerous character of the proposals he commends so warmly.

The Bryan proposition as now made and accepted furnishes a plan of distribution of notes that is skilfully devised. The printing of the notes is a simple matter, but no advocate of greenback theories has heretofore been able to suggest any practical way by which they could be put in circulation. Mr. Bryan himself has not always been clear upon this point. In a speech made by him in 1894 he says:

"If it is said that we must institute banks of issue in order to put money into circulation, I answer that there is a better way. The issue of money by the government directly to the people gives us a safer money and saves to the people as a whole the profit arising from its issue. When a bank issues money you must pay the market rate of interest in order to get it, but when the government issues money the people save the interest if the money is afterward called in, and they save the principal also if the money is kept in circulation. Numerous plans have been suggested for putting this money into circulation. Some have an idea that a government issue can only be put forth by loaning it to the people, either directly or through the agency of banks.

"There are, in my judgment, other and better ways. If a limited amount is issued, and of course the amount must be strictly limited, and it is loaned to the people, partiality will be shown in its distribution, for only a few, relatively speaking, can be accommodated.

"But aside from the danger of placing so great a power in the hands of the dominant party, there are plans more just and equitable than that of loaning. The money can be used to pay the expenses of the government, as the greenbacks now in circulation were used to pay the expenses of the war. If Congress

decides to increase the currency a certain amount annually, say for illustration, fifty millions a year, it can reduce the tax levy to that extent and the people will receive the benefit of the issue just in proportion as they pay taxes, for they will save to that extent the taxes which they would otherwise pay."

Aside from its announcement of general principle there are two points in this quotation that are worthy of attention. He says that of course the amount must be strictly limited, and calls attention to the danger of placing so great a power, that is, the power to loan money, in the hands of a dominant party. It would seem that Mr. Bryan's ideas upon the subject are progressive. He certainly could not have anticipated in 1894 that it would be possible for him to secure the adoption of a plan of distribution much more comprehensive in its character than he at that time thought wise to advocate. Mr. Bryan, in his letter to which I have referred, reiterates with increasing emphasis the statement that a government issue of notes through a board of government officials is a distinct triumph for the people. If the method of distribution by loaning notes to a class of banks is a triumph for the people, why not make the triumph more definite and beneficial by loans on similar terms to all banks, or to all individuals or corporations doing business, or, better still, directly to all the people? If the proposals for note issues contained in the bill are really in the interest of the people, why not make them comprehensive and include all the people rather than a certain privileged class? Why not give the people the profits of issue rather than confer them on undeserving middle men? If the United States is to engage in the business of loaning its obligations on collateral, then logically the demand for the loaning of government money on warehouse receipts issued on deposits of cotton and grain cannot be resisted.

It is not surprising that Mr. Bryan and his followers should be but little concerned as to the other details of the bill. I have no disposition to detract from the credit to which Mr. Bryan is entitled for the victory he has attained, but I think we have a right to ask that the American people should be given an opportunity, under the circumstances, for a full hearing upon the question before a judgment is rendered adverse to their highest interests.

The incorporation of the provisions for government note issues in the administration bill is certainly a great personal triumph for Mr. Bryan, but it is, at the same time, an emphatic condemnation of the theories of government and the economic teachings of every great Democratic leader from Andrew Jackson and Thomas H. Benton to Samuel J. Tilden and Grover Cleveland. It is undoubtedly true that the support of Mr. Bryan and his followers was necessary to secure any legislation upon this subject, but it is unfortunate that to secure this support it seemed to be necessary to sacrifice the cherished principles and traditions of a great party.

The ascription by Mr. Bryan of transcendent importance to the issue of government notes by a government board, taken together with the propositions which have been offered by two leading members of the Senate committee, to issue United States notes in place of gold certificates, national bank notes, and government bonds, indicate that the bill as it now stands is but the first step in a revolutionary program. The bills I refer to contemplate the issue of two dollars of United States notes to take the place of one dollar of gold certificates which are to be retired, the gold retained in the treasury to be issued as a reserve for the new notes issued on a fifty-per-cent basis. The gold upon which gold certificates have been issued is held as a trust fund by the United States under a solemn pledge made

in the act of 1900 that it shall not be used for any other purpose. The exchange suggested, if carried to its conclusion, would result in unbounded inflation.

The policy of issuing gold certificates based on a deposit of gold was adopted deliberately and with wisdom as a means of providing a currency absolutely safe under all circumstances, and to secure and encourage the use of gold through its representatives. To abandon this policy and use the gold through manipulation of notes for other purposes, not only would involve the good faith of the government, but would be extremely dangerous from the point of view of the public interest. The fact that proposals of this kind have been made by responsible legislators points the way which is sure to be followed if we once enter upon the policy of government note issue.

THE TYLER PLAN.

In the proposals to create a Federal Reserve Board and to provide for the issue of government notes, the authors of the House bill followed a plan submitted by President Tyler to Congress in 1841 for the creation of an Exchequer Board. It is quite natural, perhaps, that Virginians should follow a Virginian President in the preparation of a plan but the selection made is a matter of surprise. President Tyler, after having vetoed, on constitutional grounds, a bill to establish a fiscal bank and another to create a fiscal agency, in his annual message suggested a plan to establish a Board of Control in place of a Bank of the United States. Following this suggestion, Secretary Forward submitted to Congress, December 21, 1841, a plan for the creation of an Exchequer Board, the designation having been changed from a Board of Control. The Exchequer Board was to be composed of the Secretary of the Treasury for the time being, the treasurer

of the United States for the time being, and three commissioners to be appointed by the President, with the advice and consent of the Senate, one of the commissioners to be appointed for two years, one for four years, and one for six years, and vacancies subsequently occurring, to be filled at the end of every period of two years. The board was authorized and directed to cause to be prepared and issued treasury notes of a denomination of not less than five dollars or more than one thousand dollars which were to circulate as money. These notes were redeemable in gold or silver on demand. The amount of the notes was limited to fifteen millions of dollars unless otherwise provided by law. They were made receivable for all dues to the United States and it was provided that the central board and all of its several agencies should keep on hand at all times a gold and silver reserve which should equal one-third of the amount of outstanding notes. The board was also authorized to establish agencies for the transaction of its business in different parts of the country, and to purchase and sell domestic bills of exchange payable in another state from that in which they were drawn. The purpose of this provision, it was claimed, was to facilitate domestic exchanges which for some time had been in a most demoralized condition, being dependent upon state banks in different parts of the country, most of whom had suspended specie payments and whose notes were at a large discount. You will notice the wonderful resemblance between the two plans—the same kind of a board with the same power over the currency, except that the amount of the notes to be issued was limited to fifteen millions of dollars in the Tyler plan; but, with the same proportion of reserves, the redemption however to be in gold and silver alone. None of the enormous powers granted the Federal Reserve Board to loan money and control the bank-

ing system of the country are, however, to be found in the Tyler plan. This plan was presented to Congress at the beginning of the December session in 1841. It was discussed at some length in both houses and finally referred to friendly committees in each house. The terms of this original plan, the character of the men who discussed its provisions, and the final disposition of the measure, all have the strongest possible interest for us in the consideration of the Democratic caucus bill. The senators who took the leading part in the discussion in the Senate were James Buchanan, Thomas H. Benton, John C. Calhoun, Levi Woodbury and Robert J. Walker, men whose right to speak for their party and its policies was not then doubted and can not now be called in question by the friends of the enlarged Tyler plan which we are now considering. It was apparent upon the presentation of President Tyler's plan that it had few friends or even apologists in either house. The principal discussion occurred before the reference of the bill to the committees.

In the Senate, Senators Buchanan and Benton led the opposition to the measure. I feel justified in quoting from the debate at length on account of its illuminating qualities. Senator Buchanan, in his speech of December 29, 1841, as reported in the Congressional Globe, said that "he had viewed the plan submitted by the Secretary in every aspect and he could see nothing in it but a great government bank. They (the Exchequer Board), were to put in circulation a government paper currency not exceeding $15,000,000 in notes of a denomination not lower than five nor higher than one thousand dollars and they were expressly authorized, according to the rules of banking, to issue three paper dollars for every gold and silver dollar in their possession. Then it was a bank of issue. Was it also a bank of discount? Could any man doubt it?

* * * * * * Mr. Buchanan therefore took it for granted that it could not and would not be denied that this Exchequer Board was a bank. * * * * * * How could it possibly be supposed that any honorable senator belonging to the party with which it was Mr. Buchanan's happiness to act could ever adopt a plan of this description. * * * * * * What would the President become, according to this plan? He was already the great fountain of political patronage; and he was to become the head of an immense moneyed institution. Protesting always that no remarks he should now make had the remotest application to President Tyler, he put the case of an ambitious and dangerous man being at the head of the Government—an Aaron Burr being in the chair—and let him have it in his power to control the whole of the public revenue; let him have at his disposal all the money of the people, with which to purchase the services of political partisans on the eve of a great presidential election, and what would become of the national liberty. All they had formerly heard about a union of the purse and the sword was mere idle declamation; but here was that union in reality, and without a veil. All the money of the people was to be subjected to the executive disposal, and the President was to become at once the fountain of individual wealth as well as of political power. The treasury bank was to be completely and exclusively under the control of the government; and an able, who should be at the same time a bad man, would be in circumstances, by the use of this double power, both political and fiscal, to spread unbounded corruption throughout the community, to subsidize the venal to the purposes of his ambition, and so to corrupt and to impair the liberties of his country, that they would be no longer worth preserving. * * * * * *

"These exchequer notes constituted in every respect a Government paper money, and what had the past history of the world invariably demonstrated to be the fate of such money? Was there one country under the sun which ever had tried it and had not been a sufferer from the experiment? Everywhere its value had depreciated from day to day, until at length it had sunk to nothing. The two most striking examples of this were to be seen in the assignats issued during the French revolution, and the continental money of our own Revolutionary days. In both cases, indeed, the paper accomplished a glorious purpose—it established and sustained public liberty, and enabled each of these nations to resist and overcome a despotic power; but as a currency, as money, it sank and sank until at length it lost all value. And should we, in these piping times of peace, when the people were abundantly able to pay all the expenses of Government, resort to an expedient suited only to the most desperate emergency, and of so tempting and seducing a character as to have been abused by every Government that had resorted to it?"*

The part which Mr. Benton took in the discussion was even more important and significant. He said:

"In his (Hamilton's) report on a national bank in 1791, he ran a parallel between the dangers of bank paper and government paper, assigning to the latter the character of far greatest danger and mischief—an opinion in which I fully concur with him."†

After quoting the report, he says:

"I can add nothing to the force of these sentiments by adding my own concurrence in them. I fully concur in the sentiment

*Congressional Globe, 27th Cong., 2d sess., app., pp. 43-4.

†Congressional Globe, 27th Cong., 2d sess., app., p. 65.

that government issues of paper are far more dangerous than bank issues—as much more so as the power and sphere of action of a government is greater than the power and sphere of action of a bank. * * * * * *

"The point of difference between them is a government bank and government paper on one hand, and a banking company under a national charter, issuing bank notes, on the other. This is the point of difference, and it is a large one, very visible to my eye; and I am free to say that, with all my objections to the national bank and its paper, I am far more opposed to government banking, and to government issues of paper money."*

And again:

"A great number of our American people * * * * * * have become possessed of a fixed idea that paper money is the *summum bonum* of human life. Possessed of this idea they direct all their thoughts to the erection of a national institution—no matter what—to strike paper money, and circulate it upon the faith of the credit and revenues of the union. No argument, no reason, no experience of our own, can have the least effect in dislodging that fixed and sovereign conception. To this we are indebted for the cabinet plan of the federal exchequer and its appurtenances, which has been sent down to us."†

Senator Calhoun, in the course of his speech, said:

"There were many and decisive objections to the scheme proposed. They had been clearly and strongly pointed out by the senator from Pennsylvania (Mr. Buchanan). He agreed with him that it would be a government bank, not only in

*Congressional Globe, 27th Cong., 2d sess., app. p. 66.

†T. H. Benton, Thirty Years View, p. 392.

effect, but in reality. * * * * * * He also concurred with the senator that it would, at no long interval, become a mere machine for issuing irredeemable paper. The report, itself, among its admissions, states that there is an almost irrepressible tendency on the part of banks to excess in their operations. It is true, but not the less so, that there is the same tendency in all paper circulations; and, if possible, stronger in most of its forms than that of the banks themselves."*

Senator Woodbury said in debate:—

"When what is called money rests for its character on naked legislation or inadequate means in specie to redeem every dollar of the paper due, affairs might, to be sure, go on confidingly while no deficiencies were threatened, no extravagant expenses incurred, or no great fallings off in resources apprehended. * * * * * * Let a scheme like this be tested by such panics and over trading as have characterized the few years past—and the whole would explode in a single month.

All the evils of old Continental money and French assignats, and all the ravages inflicted by colonial paper, before the Revolution, would be probable, if not inevitable. * * * * In such a panic as that in 1834, or 1837, or 1840,—and many more which might be named, contrary to the views in the report, that they are only few and far between—and the Fiscal Agency would be broken in single day."†

More important even than the discussion in the Senate were the expressions of Andrew Jackson with reference to this Tyler plan for an Exchequer Board. In his message proposing the plan, President Tyler had claimed that the plan he proposed was similar to that which had been advocated by President Jackson, and Senator Rives of Virginia had made a similar claim in the Senate. These claims having been brought to the

*Congressional Globe, 27th Cong., 2d sess., p. 70.

†Congressional Globe, 27th Cong., 2d sess., app., pp. 55-6.

attention of Jackson, he wrote two letters to William B. Lewis, his intimate friend and the man who had been the chief of his kitchen cabinet. In the first of these, he said:

"I informed you in my last, that I regretted that part of the President's message that recommended a paper currency of treasury notes, and as the President has observed that it was shadowed forth by my message of 1830, I sincerely regret that he did not fully embrace the propositions therein set forth. Turn to it and you will find that there is no expression there that will justify the idea of Congress making a paper currency of any kind, much less by issue of treasury notes—and it is impossible to make out of any paper system, a sound circulating and uniform currency."*

In the second letter written two weeks later, he said:—

"I discover that Mr. Rives has adverted to my message of 1830 in support of the measures recommended. I regretted to see this—it shows him uncandid, because there is no likeness between them. * * * * * * My explanatory remarks show this. * * * * * * The word bank was used by me in its proper sense to distinguish it from an incorporated bank—*a place where the money of the government was to be kept,* to clearly show that it was to have no stockholders, no power to issue paper, discount or exchange and if Mr. Rives will read all my messages and my farewell address which was intended to give my full views on banking he will find he has done me great injustice in referring to my messages, as authority for the fiscal plan proposed by President Tyler. Every one who knows me, must be aware of my universal hostility against all government paper currency. The old continental currency was sufficient to convince me that a greater curse could not visit a nation than a paper currency."*

*W. G. Sumner, Andrew Jackson, pp. 286-7.

After these discussions, the bill was referred to committees as I have already stated. In the house report, the committee of which Caleb Cushing was chairman recommended a change requiring gold and silver to be held equal to the amount of notes issued, making them substantially coin certificates. They held that it was no part of the business of the federal government to carry on, directly or indirectly, a business of discounting notes or bills or otherwise lending money, or to furnish funds to be so lent. The committee of the Senate recommended changing the formation of the board by leaving out the *ex-officio* members. They also provided that the amount of note issue should never exceed the actual amount of specie on hand, dollar for dollar, stating that the committee were of the opinion that no paper should issue on the credit of the government to circulate as money, and that such issue would be in violation of a great, fundamental principle. Even in the modified form proposed, the bill found no substantial support in either house and the Tyler plan went down into oblivion with the unanimous disapproval of the men of all parties, only to be restored three quarters of a century later as a Democratic party measure. Every criticism made by the great leaders of the Democratic party in 1841 of the Tyler plan would apply with even greater force to the plan of the bill we are considering. It seems somewhat singular that a Democratic administration should have selected the plan of John Tyler for the creation of an Exchequer Board as a model for their plan of a Federal Reserve Board.

FEDERAL RESERVE BOARD A GOVERNMENT CENTRAL BANK.

I have stated that by the establishment of the Federal Reserve Board Congress would create a government central bank. The board is a bank of issue, as all the government

notes authorized by the bill are issued by it. It is a bank of discount as it makes loans of government notes to Federal Reserve Banks, taking commercial paper as collateral at a rate of discount fixed by the board. The following recital in outline of the powers granted and functions assigned by the bill to the Federal Reserve Board fixes its character as a central bank. The imperial powers improvidently granted, and the authority given the Federal Reserve Board over reserve banks and their members, are vastly greater than those exercised by any central bank in existence. The reserve banks and their offices scattered throughout the country are for most purposes merely branches of the central board. This board is described by the committee which reported the bill in the House as a "general board of management intrusted with the power to overlook and direct the general functions of the banks referred to."

The Federal Reserve Board has authority to create and readjust districts within which federal reserve banks are to be located. It may permit state banks to become members, and may also suspend such banks from membership at its discretion. It may establish branches of the federal reserve banks within each federal reserve district and prescribe their management. There might possibly be 200 of such branches in the United States on this basis. The board fixes the compensation of all the directors of the federal reserve banks. Of the nine directors of the reserve banks six, three representing the shareholding banks and three representing the commercial and other interests of the district, are elected by the member banks acting in groups which are established by the agent of the Federal Reserve Board, and the elections are held under the supervision of the same agent who, by various provisions, becomes an important, if not a controlling factor in all elections.

The central board appoints three of the nine directors, and it has the power to remove three others, if in its opinion they are not proper representatives of the commercial interests of the districts. The central board appoints the chairman of the board of directors of each reserve bank, who is evidently intended to be the manager of the bank, and who is also the agent of the central board for the transaction of its business. He reports all acts to the central board, which fixes his salary and can remove him at any time without notice and appoint another in his place. The directors of the bank have no control over him or his acts. The central board has an office in the reserve bank in charge of its agent, the chairman of the board. These provisions taken together give the central board a potential voice in the management of the reserve banks.

The central board has the right, subject to an exception, to determine or define the character of paper eligible for discount by the federal reserve banks; to fix the conditions under which member banks may discount 120-day paper; to review and determine the rate of discount which can be charged by federal reserve banks; to require, or, on application, to permit any federal reserve bank to rediscount paper of any other federal reserve bank. With reference to reserves, the power of the central board over the reserves of the federal reserve banks and of all national banks is plenary. It is authorized to suspend any and every provision of law with reference to the reserves of reserve banks or national banks, except that having reference to note issue. It has the power to add to the number of cities classified as central reserve cities, to reclassify central reserve or reserve cities, and to designate any of the banks therein as country banks, at its discretion. The central board is authorized to issue, without any limitation as to the amount, obligations of the United States and to loan these on collateral to the

reserve banks. The agent of the central board, who is also chairman of the board of the reserve bank, acts in the double capacity of applicant for loans and custodian of the collateral offered as security for the loan of government notes which may be made at any time, and has charge also of changes in collateral. The central board may, at its discretion, require a deposit by the federal reserve banks of a redemption fund of five per cent of the notes issued, and it can fix the rate of discount, not however less than one-half of one per cent per annum for the loans of government notes to the reserve banks.

It may, at its discretion, suspend the operations of any federal reserve bank and appoint a receiver therefor. The routine business of the federal reserve banks is also under the control of the central board. It may make regulations governing the transfer of funds between the federal reserve banks. The central board may itself act as a clearing house for federal reserve banks or may require, at its discretion, the federal reserve banks to act as clearing houses for shareholding banks. It may remove officials of the banks for incompetency; it may require the writing off of doubtful or worthless assets upon the books of the reserve banks; it may levy semi-annual assessments upon the reserve banks for the expenses of the central board.

The central board is given the power to exempt national banks from those provisions of law which restrict the character of their investments, and may reduce the number of cities within which national banks are permitted to make loans upon real estate. It is given not only the power to regulate the savings departments of national banks, but it can fix the character of their investments, which may differ in different parts of the country. The central board may fix the terms upon which national banks may apply for authority to establish branches in foreign countries, and it may reject any application on the

ground that its approval would be inexpedient. By an unusual provision, the central board is authorized to perform all the duties, functions and services implied by the act in addition to those that are specified. How extensive this grant of power may be, it is impossible to say. By another provision, extraordinary in its character, the central board is authorized to levy taxes on all banks, national, state, or reserve, whenever their reserves fall below a point to be fixed by the board. There is no limit fixed for the amount of the levy and no rule laid down which is to be followed in making the assessment. It will not be possible for me in the time I have at my disposal to take up and examine in detail this long list of powers granted to the central board. It must be evident that it contains more than one grant of legislative power which, upon principles heretofore declared by the courts, would be pronounced unconstitutional.

By the different provisions of the bill with reference to reserves it might happen that one bank in the city of New York or any other reserve city would be required to have 18% reserve, another one 12% and another one no reserve at all. The mere existence of this power of discrimination might, in itself, have a very persuasive influence, political or otherwise, upon the attitude of all the banks towards an administration which could dispense favors and impose penalties of this nature.

The Federal Board is given the power to determine each week, or as much oftener as required, the rate of discount to be charged by each reserve bank for each class of paper. This provision contemplates different rates for different sections of the country and different rates on different classes of paper. In other words, the board sitting in Washington will be called upon to review and determine at least once a week, 48 rates of

discount covering the entire country, and to fix these rates—in the language of the bill—"in view of accommodating the commerce of the country."

The fixing of this miscellaneous collection of rates could not possibly be made effective for any of the purposes for which bank rates are fixed and changed in other commercial countries. There can be no justification for fixing a different rate of discount to be charged by a government institution, supposedly created in the public interest, on the same class of paper in one section of the country as distinguished from another. The bill evidently contemplates a higher discount rate in the South and West than in eastern or central localities. In other words, the rate might be 4% in New York and 6 or 8% in Nebraska or Texas.

It should be borne in mind that we are dealing with official rates and not commercial rates, which are controlled more or less by local conditions. Any substantial difference in rates fixed for federal reserve banks would send standard commercial paper from one district to another by direct or indirect means, to secure the benefit of the lower rates. In my opinion it is of the very highest importance to the people of the South and West that there should be a uniformity of rates in all the reserve banks for identical classes of paper. Any other course would result in an unjust discrimination by the national authority between sections. Uniformity of rates is most important from the standpoint of the desirability of securing approximate equality of rates and facilities to every section of the country. There is no use in establishing standards for commercial paper if paper representing the products of the South and West is to be discriminated against by a government agency in contrast with paper representing the products or industries of the East. One of the principal purposes for which this government

machinery is to be erected is to give the paper representing the products and industries of the country a new and better status in our own markets and those of the world. Can this be accomplished if we declare that the securities of great sections of our common country are not entitled to the credit which is accorded to those of other sections in government banks.

One of the main purposes of creating the federal reserve banks is to secure such a concentration of reserves as will permit their prompt use in any amount and in any part of the country to establish confidence and avoid panics. I think it must be evident to anyone familiar with conditions that the creation of these twelve or more federal reserve banks would not accomplish this purpose.

The Federal Reserve Board, an organization without capital or financial responsibility, has no reserves of its own and is given no control over the reserves of the reserve banks. It has power to increase, at its discretion, the demand obligations of the United States, but it has no power, in times of stress, to keep the banks or the Treasury on a gold basis, or to prevent suspension of domestic or international exchanges. It is given, improvidently, autocratic powers over business of the banks—which can only be successfully managed by the men who own and control existing institutions and who are familiar with all local conditions. It is granted powers that can only be properly exercised by trained bankers, and it can take no effective action for relief in times of national or international crises. In great emergencies when some sustaining power is necessary, it will be powerless. It can take no steps in the interest of the country at large to control the movement of gold or to increase the supply of gold through negotiations with the great banks of Europe or otherwise. It might be able to control elections and insure the success of a political party,

but, in times of stress, it would have no power to preserve public or private credit. It would be able to loan government money to impecunious banking friends or to deposit government funds in "pet banks," but it would be unable to assist a bank or a community in time of serious trouble. It would have no status in the commercial world, and its standing at home would be fixed by its importance as a political machine rather than as a force in financial circles.

JACKSON'S GOVERNMENT BANK.

Friends of a government central bank quote General Jackson as one of its advocates. It is true that he suggested on several occasions that it might be desirable to establish a government bank, but these suggestions were always more or less vague in character, and he never committed himself in detail to any definite plan. His opponents, however, claimed that General Jackson intended, by these indefinite suggestions to advocate the creation of a government central bank under political control, and that the effect would be to place the whole banking power of the country at the mercy of the president. I think it may be said that this claim did not fairly represent General Jackson's views and that he intended merely an institution like the independent treasury that should take over government business alone. The quotations which I have already made from his letters to William B. Lewis are confirmed in this respect by his statement with reference to the removal of the public deposits as follows:

"It is the desire of the President that the control of the banks and the country shall, as far as possible, be entirely separated from the political power of the country as well as wrested from an institution which has already attempted to subject the government to its will. In his opinion the action of the

general government on this subject ought not to extend beyond the grant in the constitution, which only authorizes Congress 'to coin money and regulate the value thereof'; all else belong to the states and the people, and must be regulated by public opinion and the interests of trade."*

The suggestion, however, led to a prolonged discussion on the merits of the government central bank.

The objections to the creation of a government central bank were never, perhaps, more clearly and forcibly stated than in the report of the House committee of ways and means of which Mr. McDuffie of South Carolina was chairman, in 1830. In the course of this report, the following statement was made:

"It will be difficult to find any warrant, either in the letter or the spirit of the constitution, for the creation of this tremendous engine of pecuniary influence. It may, indeed, be doubted, whether all the branches of the legislative authority united have any constitutional power to lend the public revenue either to individuals, corporations, or states, without reference to the objects to which it shall be applied. But, whatever may be the power of Congress on this subject, it appears to the committee to be inexpedient, in every view of the question, that the government should be converted into a great money lender. There is no species of trade in which it would be wise for the government to embark; but of all the variety of pursuits known to human enterprise, that of lending money by the government to the citizens of the country, would be fraught with the most pernicious consequences. * * *

"In the first place, it is a business to which, in the very nature of things, no government is adapted, and, least of all, a

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*F. N. Thorpe, Statesmanship of Andrew Jackson, p. 280.

popular government. There is no employment of capital that requires a more vigilant and skilful superintendence. * * *

"Nothing that has not happened can be more certain, than that every unfavorable vicissitude in trade, every period of commercial distress and embarrassment, would give rise to importunate and clamorous calls for indulgence, and for an injudicious extension of discounts, which no administration would have the firmness to resist. * * *

"The government would have scarcely any faculty of resistance, when appeals for indulgence should come from all quarters of the Union, sustained by the strong plea of public distress and embarrassment. * * *

"But the inevitable tendency of a government bank to involve the country in a paper system, is not, in the opinion of the committee, the greatest objection to it. The powerful, and, in the hands of a bad administration, the irresistible and corrupting influence which it would exercise over the elections of the country, constitutes an objection more imposing than all others united. No matter by what means an administration might get into power, with such a tremendous engine in their hands it would be almost impossible to displace them, without some miraculous interposition of Providence.

"Deeply impressed with the conviction that the weak point of free government is the absorbing tendency of executive patronage, and sincerely believing that the proposed bank would invest that branch of the government with a weight of moneyed influence, more dangerous in its character, and more powerful in its operation, than the entire mass of its present patronage, the committee have felt that they were imperiously called upon, by the highest considerations of public duty, to express the views they have presented, with a frankness and freedom demanded by the occasion."*

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*M. St. C. Clarke and D. A. Hall, Bank of the U. S., pp. 758-9.

NATIONAL BANKS.

It is sought to make the control of the Federal Reserve Board over the banking business of the country effective by compelling national banks to subscribe within a year to the stock of the federal reserve banks a sum equal to twenty per cent of their capital under penalty of dissolution in case of failure or refusal. The national banks are further required to deposit with the reserve banks a portion of their reserves. These drastic provisions disclose an amazing want of confidence on the part of the author of the bill in the wisdom of its methods. The banks are now acting under charters for a fixed period under certain definite conditions which have been faithfully lived up to with the result that note holders have suffered no loss, and that depositors and shareholders have lost only infinitesimal amounts. The United States is bound by every equitable consideration to protect the banks from serious losses on their investments in government bonds.

I submit that it is not fair to impose upon these institutions as the price of their continued existence new, onerous, or impossible conditions especially in legislation enacted ostensibly to assist them the better to discharge their duties to the public in times of trouble. The conditions imposed are of such a character that unless changed they cannot be accepted by the smaller banks which form a large majority of the national banks, without serious losses and dangerous impairment of their resources and their ability to serve the public. It will be noted that the penalty of dissolution goes into effect in one year, even if it has not been possible within that time to organize a single federal reserve bank with the requisite capital. It would seem that the only method by which a national bank could avoid the serious consequences of this legis-

lation would be to take out a state charter and transfer its business through voluntary liquidation.

It does not seem possible that the authors of this bill can have considered the dreadful consequences that would ensue if the national banking system is broken up by enforced dissolution or liquidation. The national banks have outstanding $742,000,000 of circulating notes and banks going out of existence must deposit lawful money in the treasury for their redemption. These banks hold $685,000,000 of 2% bonds. A state bank could not afford to hold these for investment and their sale would mean a large loss to the owners, and the credit of the United States would suffer unmeasured injury. It is safe to say that the serious disarrangement of credits, the contraction of circulating medium, and the destruction of confidence that would certainly arise from a transfer of any considerable amount of the banking business of the country from the national to the state system would end in a financial panic such as has never been seen in any country.

RESERVES OF NATIONAL BANKS.

Under the provisions of the national banking act establishing the character and amount of reserves for national banks a system has grown up which in the main is satisfactory to both the banks and the public. It has been found ineffective in times of crisis, and the rigid provisions forbidding discounts whenever the legal limit of reserves is reached is unsatisfactory in operation, but there has been no popular demand for a reduction of the amount of reserves required. As authorized by law country banks maintain balances with reserve agents in local centers and in central reserve cities. This arrangement affects favorably the convenience and the revenues of banks of all classes. Banks are obliged to maintain balances with cor-

respondents or reserve agents for exchange and collection as well as reserve purposes. Banks in reserve cities have been able to use the deposits of country banks, and this use has assisted in the development of important business centers in various parts of the country.

The relations between country banks and their reserve agents have been usually of an intimate character. The banks which act as reserve agents are, in almost every case, important institutions of large capital and resources, and in ordinary times amply able to respond to any demands for the reserves in their custody, as well as to furnish assistance and support to their country correspondents in cash or credit whenever required.

The country banks receive a revenue from their deposits with reserve agents and can invest a portion of their capital more profitably than in the capital of the reserve banks. If the bill should pass in the form proposed it would take away from the country banks an important part of their revenue by the requirement that reserve banks shall accept checks and other collection items at par. But these results are unimportant compared with the fact that their deposits in reserve banks might not be available even in the ordinary times for reserve purposes, as the scheme of the bill contemplates making the reserve banks discounting machines which may be kept in perpetual operation to their full capacity, in order to prevent a contraction of credits. The framers of the bill evidently not only intend that the reserve banks shall make loans to their members to the extent of their deposits, but it is suggested that they may loan them the money to pay for their subscriptions to the capital of the reserve banks. Banks that do not borrow money for loaning purposes would find that their reserve had disappeared in loans to rival institutions.

It should not be forgotten that the United States has a first lien upon all the assets of the reserve banks as security for government deposits and for issues of government notes which have been loaned to them. In cases of large losses by the banks this preference would be a serious matter for the bank's creditors.

The change from the old system to the new involves a direct loss to the country banks and imperils their investments and deposits. National banks are required to submit to the losses and inconvenience I have referred to.

The principal advantage which national banks have over state banks is in the profit they derive from their note circulation and the fact that they are permitted to share at times in the benefits of government deposits. Both of these advantages are practically removed by the bill, one to take effect immediately and the other by the progressive reduction in national bank note issues. Country banks hold a much larger proportion of their capital in United States bonds than city banks. These bonds have been bought in many cases within the last ten or twelve years, and bought with the belief that the national banking system was to be permanent and that they were not likely to be deprived of their charter rights. The losses on their holdings of government bonds, unless Congress shall take effective means for their relief, will be a serious matter to these institutions. 59% of the national banks have less than $100,000 capital; 91% have less than $250,000 capital. Of state banks the proportion of small banks to the total number is much greater.

We should not lose sight of the fact that the national banks in many localities have not been able to compete successfully for business with the state banks. In 1912 67% of the individual deposits of the country was in state institutions.

The number of these institutions is practically three times as great as that of national banks. The remarkable growth of state banking institutions has been largely owing to advantages growing out of more liberal reserve requirements and out of the fact that they have been able under state laws to transact business which is forbidden to national banks.

With reference to state reserve requirements, ten states have no provisions at all for reserves. In almost every state the provisions are more liberal than the national requirements. In all states national bank notes can be counted as a part of the reserves of state banks, and in some states the reserves may consist in part, and in one state wholly, in securities. The laws of all the states leave the banks almost entirely free to deposit their funds in the banks of the great commercial centers. In most states they are entitled to keep a larger proportion of their reserves in the hands of reserve agents than is permitted by the banking act or the proposed bill.

With legislation depriving national banks of the advantages which they now have and imposing upon them new and onerous burdens, and with the state institutions retaining all the advantages which they now have, it is not unreasonable to expect the decline if not the extinction of the national system.

It is impossible to predict the effect which the radical reduction in the amount and change in the custody of the reserves of national banks will have upon the business of the country. It is certain that the effect at first will be to create confusion and uncertainty, and that the readjustment of credits and withdrawals of deposits will lead to credit contraction. Just what amount of credit expansion will take place later owing to reduction of reserves depends upon whether the national banks accept the legal limit of cash reserves fixed by the bill as a basis for their future credit operations. One of the witnesses

who appeared before the Senate committee estimated that the national banks hold 12.75% of their net deposits in cash. He estimated that under the House bill a cash reserve of 6.8% will be required. If the national banks should continue, notwithstanding the provisions of law, to maintain a cash reserve of 12.75% against their liabilities, the result of the changes proposed by the bill would be a contraction of credits. If on the other hand the credit business of the national banks is to be conducted hereafter on a 6.8% cash basis, this, taken in connection with an expansion of note issues, would certainly lead to indefinite and destructive inflation.

One of the purposes of the proposed legislation, as stated by its friends is to take from the bankers the control of the banking and monetary interests of the country and to place it in the hands of a Federal Reserve Board, and to prevent the concentration of money in New York and other great financial centers by the creation of twelve federal reserve banks. The reserve banks are to take over and hold reserves now held by the banks in reserve and central reserve cities, with a view of weakening, if not of destroying, the supremacy of the money power, or of the money trust, as it is sometimes described by political reformers. To aid in the accomplishment of this purpose, the new system of reserves as well as of reserve banks is proposed. Keeping these purposes in mind, it is desirable to examine somewhat in detail the methods proposed for their accomplishment. The cash reserve of the banks in the central reserve cities is reduced from twenty-five to nine per cent. The change in the custody of the reserves is more apparent than real.

59% of the national banking capital of the country is located in thirteen states, classified in the comptroller's report as eastern and middle western states, while the other thirty-

six have 41% of the capital. The thirteen states have 67% of the banking resources of the country, while the other thirty-six have 33% of these resources. The capital of the federal reserve banks is fixed by a percentage of the capitalization of the national banks. It follows that 59% of the capital of these banks will be located in the thirteen states. The deposit of the reserve in these thirteen states, outside of government deposits, will be 67% of those of the country. If we assume that the central board will not exercise the powers of control over the management of the reserve banks and that the banks in these states will have the potential voice in the management of the reserve banks in their section that some of the friends of the measure claim, the supremacy of the money power of the East will be strengthened rather than weakened by the House bill. A portion of the capital and resources of the section are transferred from one class of organization to another without change of ownership. A new machine to be operated by the same men is set up with government approval. The banks in different sections are not controlled by conflicting interests, but if they were, this legislation would only emphasize existing conditions.

If four reserve banks should be located in these thirteen states they would, on the basis that all national banks assented, have a capital of about fifteen millions each. The eight located in the remaining thirty-six states would have a capital of about five millions each. The reserve bank in New York would have a larger capital and much greater resources than the three that might be located in the thirteen southern states.

It is true that a very large amount will be withdrawn, by the operations of the bill, from the banks in the reserve and central reserve cities, but at least two-thirds of this amount will be redeposited in the reserve banks in the thirteen eastern and

middle western states. If we assume that these reserve banks are simply adjuncts of existing institutions, this process will largely consist of taking money out of one pocket and putting it into another.

The treatment of bank reserves in the central reserve cities is interesting. They now hold cash reserves amounting to 407 million dollars, this being 25% of their net deposits, and this must be held in their vaults and cannot be used for any other purpose. By the terms of the bill they would be required to hold only 146 millions in cash and 261 millions would be released for other purposes; but 146 millions might be deposited in a reserve bank where it would form a basis for discount, leaving 115 millions available as a basis for credit expansion. If cash reserves are accepted as the basis for credit expansion, the banks in the central reserve cities will be able to increase their loans in the proportion of 9 to 25 under the new law as compared with the old. If the bankers of New York and other central reserve cities should consult their selfish interest they would be found earnest advocates of the new plan.

It was undoubtedly intended that the reserves concentrated in the reserve banks should be made available for the assistance and support of any bank or banks in time of serious trouble. Heretofore, scattered reserves have been found useless and panics precipitated by a general scramble of banks throughout the country to increase their cash reserves. The trouble, I am sure, would be intensified rather than relieved by the creation of this new class of banks. In addition to 29,000 banks, each looking out for itself, we should have twelve reserve banks of varying size and importance, each trying to protect its own reserves and the interests of its own section. The great disparity in the financial strength of these banks

would give some great advantages over others in this contest. New York and Chicago, with their immense resources and foreign connections, if relieved from responsibilities for other sections of the country, as proposed, could easily obtain the gold necessary to protect themselves and enable them to meet their obligations. Other sections might not be as fortunate. That the authors of the plan believe that it could not be relied upon in emergencies and that it would fail when a real concentration of reserves and resources was necessary, is shown by the provision that the central board may require one reserve bank to rediscount the commercial paper of another. It would be almost impossible to put this plan of relief into operation without doing more harm than good. Its wise administration would necessitate an intimate knowledge, on the part of the central board, of the financial conditions and loaning power of each of the reserve banks, otherwise the transaction might of itself precipitate a crisis.

The other method by which it is proposed to afford relief to banks or communities in trouble, is by a transfer of government deposits from one reserve bank to another. The government cannot afford to maintain a large surplus for the purpose of transferring it from one section to another for relief purposes. This method would be equally perilous with the other. Transactions of this character, as well as the enforced discounts, would appear in the weekly reports of the reserve banks, and the knowledge that a bank in any section of the country was in such need of assistance as to demand help on such terms, would be likely to cause a run upon the advertised institution and the attempt to relieve might not only prove futile, but productive of serious results. The deposit of treasury funds in 1907 was efficacious in helping to restore confidence, but in that case the money was taken from the treasury, and not withdrawn from

one bank to be deposited in another; otherwise the beneficial results would have been lost.

The suggestion of these questionable methods of making the resources of one reserve bank available for the relief of another, discloses the inherent weakness of the plan. To be effective, the capital and resources of reserve banks must be concentrated under the control of some central organization.

CONTROL OF FEDERAL BOARD.

As I have shown, by the terms of the bill national banks are obliged to furnish the capital and the deposits of the federal reserve banks, the only other depositor being the United States. They are obliged to invest a part of their funds and to place a considerable part of their resources beyond their own control or to submit to a sacrifice of their property and business. This large contribution of national banks is placed under the control of political appointees, the majority of whom of necessity cannot have the knowledge or experience to qualify them for the important duties assigned to them.

The national banks are forced into the position of stockholders and principal creditors of the reserve banks. The reserve banks are forced to conduct their affairs under instructions from the central board, and yet neither the reserve banks nor the national banks are allowed to participate in any way in the management of the central board. It is not a question whether the banks are to be permitted to control the board created to supervise their transactions, but whether they shall have any voice whatever in the management of their own property. There is nothing in our form of government, the basic principles of democracy, or the equitable principles which should govern the organization of society, which warrants any such exclusion. If this usurpation of the rights of property of

protesting citizens is not without warrant in our constitution, it certainly is in violation of every principle of equity.

The attempt is made by the friends of the measure to justify this exclusion from the councils of the proposed government central bank by a reference to the means by which central banks of Europe are controlled, but a comparison of the manner in which the central banks of the three most important commercial nations of Europe are controlled with that suggested for this government central bank would show that no precedent can be found in European practice for the action contemplated in this case. The question at issue is what, if any, voice shareholders have in the management of European central banks. European central banks have no control whatever over the joint stock banks or their management.

A comparison of the manner in which the central banks of the three most important commercial nations of Europe are controlled with that suggested for this government central bank, is of interest to us. With a very few exceptions (Russia and Sweden are the only important ones) the central banks of Europe are private institutions, in the sense that their shares are held entirely by private owners, but the character of their management varies.

In the case of the Bank of England, the government has no voice in its management, nor does it own any stock in the bank. The supreme control is vested in the governor, deputy governor and 24 directors, all elected annually by the shareholders. It is the custom of the shareholders to elect merchants, representatives of important business houses, to membership on the board, and to exclude directors of joint stock banks, and brokers. This custom is undoubtedly a proper one, and is, I think, adopted universally in other institutions of a similar character. I have never heard of any suggestion that

a different course should be followed in this country. The inclusion, however, of merchants as the principal directors of the Bank of England admits to membership representatives of all the greatest banking houses of the world. These merchant houses are called banking houses in this country, and on the board of directors of the Bank of England are found the representatives of houses like the Rothschilds, Barings and Morgans. The case we are considering is not one as to who should be selected by shareholders on a board of direction, but whether shareholders should have any representation in the management.

The Bank of France is a private establishment and the government owns no shares. The management of the bank is in the hands of a governor and two deputy governors, who are appointed by the Chief of State and a board of fifteen regents (five of the regents must be chosen from the commercial and industrial classes), and three censors (auditors) who are elected annually at a meeting of shareholders. The regents correspond practically to the board of directors of our banks. They decide upon all important matters of policy and management, including the fixing of the bank rate.

The administration of the Imperial Bank of Germany is carried on by three boards: (1) The Curatorium, consisting of the Chancellor of the Empire, one member appointed by the Emperor, and three elected by the Federal Council from its own members. The board meets once in three months and very rarely interferes in the actual management of the bank. (2) The Directorium, or board of managers, consisting of the president, vice-president and seven others, who are the active managers of the different departments of the bank and who are appointed for life. These are recommended to the Emperor by the Federal Council and appointed by him. In their

appointment the Central Ausshuss are consulted. (3) The Central Ausshuss. The powers and functions of this board are defined by the Vice-President of the Reichsbank, Dr. von Glasenapp, as follows:

"The third body, the Central Ausshuss (which takes the place of our directors), is composed of 15 members, who are elected at the annual meeting of the stockholders, together with 15 alternates, who serve in the absence of any of the members of the board. This body meets once a month. From among their numbers they appoint a sub-committee, known as deputies of the Central Ausshuss, of 3 members and 3 alternates. The deputies meet weekly with the president and managers. The Central Ausshuss are made familiar with the transactions carried on by the bank and give their advice and recommendations to the Direktorium in reference thereto. In practice, their advice is generally carefully considered and taken. In the fixing of the bank rate, it is their custom to call a special meeting, if need be, of the Central Ausshuss, who always confer in regard to the advisability of a change in the bank rate."

MANAGEMENT OF BANKS.

The experience of banking institutions generally establishes the fact that the best results are obtained by leaving the practical management of banking affairs to men of tried capacity and experience, whose positions are of a permanent character, and whose services in most cases command large salaries on account of the nature of their responsibilities. Successful banking on any considerable scale can be carried on only in this way. There is a clear distinction between the actual managers of a great bank, that is, those who have charge of its technical banking business, and the directors

who pass in a more or less perfunctory way upon the action of the managers, and who decide upon important questions of general policy affecting the bank. This distinction is rarely defined by law, but it exists in all well managed banking institutions. It is sufficient to say that there is no important banking institution in existence that could prosper under the sole management of a political board whose membership was certain to be changed at least once in four years.

SOCIALISTIC CHARACTER OF THE BILL.

I am aware that there seems to be a marked tendency in recent years, in some quarters, to abandon the doctrine that States have still any virile powers under our form of government, and to assent to the concentration of all powers and authority in the national government, to be exercised through Congress, or in later days, through agents of the executive. But this is, I think, the first attempt to give a government board the right to manage a great business, which is, more important in its intimate relations to all the people than any other. If the attempt is successful it will be the first and most important step toward changing our form of government from a democracy to an autocracy. No imperial government in Europe would venture to suggest, much less enact, legislation of this kind.

It will be remembered that the Federal Reserve Board consists of three members of the President's official family and four others to be appointed by the President and confirmed by the Senate. One of the four members is made manager and executive officer of the board, and acts under the supervision of the Secretary of the Treasury, who is made chairman of the board. It is provided that not more than two of the appointed members shall be of the same political party. These pro-

visions taken together fix the character of the board as a political organization. Every change in administration means a change of four, and probably five, of seven members of the board.

As I have shown, the powers granted to this central board are intended to give it the control of the functions and the business of the reserve banks by arbitrary, direct, or indirect methods. It is clearly intended that the government of the United States, through these instrumentalities, shall be placed in a position where it can control and manage the banking business of the country. It is further intended that government obligations shall ultimately take the place of all other forms of note issues. This general purpose is either illy concealed or openly announced by the promoters and advocates of the plan.

The creation of this board, with its improvident grants of executive and legislative authority is repugnant to every fundamental principle of popular government. No instrumentality could be further removed from popular control. The functions of the board are exercised in secret and there is no provision for publicity of any kind, except an annual report to Congress. There can be no review of its opinions and no appeal from its decisions. It is doubtful whether its members could be impeached for flagrant abuse of power. They are appointed by the President and apparently responsible to him alone for the manner in which they discharge their duties. This attempt to give to a political oligarchy the power to control the banks and currency of the country, to be exercised at its discretion, with no means of preventing or punishing abuses, is promoted by the same men who are proclaiming their purpose to destroy monopolies and to repeal all grants of special privilege. No monopoly or grant of special privilege

could be so great, so far-reaching in its consequences, as that proposed by the bill under consideration.

The proposition that our government has the power, or could properly exercise the right, to take possession and control, through its agents, of the private business of its citizens, has never before been seriously advocated in this country. No reason can be given why the United States should take over and manage the banking business of the country which does not apply with equal force to any of our important industries or business organizations. In other countries the doctrine of state socialism has found vigorous support from a limited class, but the experiment of managing private business by government agencies has not yet been tried.

The creation of this board, however, is clearly a favorable response to socialistic demands. The aims of socialism were recently defined as follows by an acknowledged authority: "It demands that the machinery of wealth-creation be taken from the individual capitalist, and placed in the hands of the nation to be organized and operated for the benefit of the whole people." There could be no more accurate description of the proposals we are considering.

It is urged, in answer that the President, having only the public interests in view, would appoint men of the highest class, men whose patriotism and loyalty to the public interests would be unquestioned, and that therefore no evil results could follow. Good appointments will undoubtedly be made, but legislators are bound to take into account the possiblity that an ambitious man in the presidential chair might use the great powers of this organization to advance the interests of a political party or to perpetuate an administration. A President who had the power to dominate his party and to dictate to Congress, if he were at the same time ambitious for the succession, might be tempted to

use for personal or party purposes an organization of his own creation whose influence for this purpose would be irresistible.

The President has not as yet, I believe, expressed his concurrence with Mr. Bryan as to the transcendent importance of government note issues. In his earlier days he was enthusiastic in his defense of the Second Bank of the United States. He said: "Only a great commanding bank, everywhere known, whose notes really and always represented gold could supply paper worth its face value in all places or keep exchanges from chaos. Such an agency of adjustment and control the Bank of the United States had proved itself to be. It had not only served its purpose as a fiscal agent of the government to the satisfaction of the treasury, but had also steadied and facilitated every legitimate business transaction and rid the money market of its worst dangers. But many of the men to whom General Jackson was accustomed to listen believed, or affected to believe, that it had done much more, that its power was used to serve a party and to keep men who were no friends of the people or of popular rights in a position to manage and corrupt the whole politics of the nation."*

The President will undoubtedly concede that we cannot adopt the Bank of the United States as a model, but we should certainly seek to secure the qualities and results which he so eloquently ascribed to the bank. The accusation that the Second Bank of the United States advanced money on the paper of its political friends, and used its control over credits to perpetuate its existence and to defeat General Jackson had more effect in arraying public opinion against the bank than any other cause.

The bill we are considering was, it is said, prepared by five Virginians. I commend to these gentlemen the serious admoni-

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*Woodrow Wilson, History of the American People, v. 4, p. 63.

tion of a distinguished son of Virginia, the friend and biographer of Jefferson, Professor George Tucker, of the University of Virginia. He said:

"Those who administer the federal government must be always expected to have a vigilant and active opposition; in other words, there will always be two great political parties in the country, one of which will be in favor of the administration, and the other will be opposed to it. Now, it is contrary to all experience to suppose that those who have so powerful a machine under their control as the whole banking power of the country, and which would be ten times as great as at present, by being undivided, would not be disposed to use it in favor of one party, and against the other; and, if skilfully used, what might it not achieve? The power of the late bank of the United States, with a capacity of only $35,000,000, was thought, by some, to be formidable to the government as well as to the state banks, and this was one of the principal reasons assigned for putting it down; but what was its power, when exerted against that of the government, and of numerous rivals, commonly equal to itself in any one place, compared with what would be the power of all the banks united, when added to that of the government? If the people were capable of being bought, of trafficking away their rights and liberties, a government, provided with such means, might be able to purchase them; and, though that should not be the fatal result, such an accession to the power and patronage of the government would make the will of its party resistless; and we know that no tyranny is more merciless and unprincipled than that of party. We every day see the men who compose it, tolerate and approve what, as individuals, they would revolt at. We may then infer, that such potent means of influence would not be conferred by any people possessing the smallest degree of discernment, or

jealousy of power, and that in this country the experiment will never be made until the love of civil freedom shall cease to find a place in the hearts of the American people."*

I feel sure that it is not necessary to remind the Senate committee who have the responsibility of recommending proper legislation upon this subject, that no credit can attach to any Congress or administration unless the legislation adopted shall prove wise and effective. The features of the bill to which I have called attention are of such a character that they should not be accepted. I have tried to show that the House bill has serious defects. It appeals to the populists by adopting their plan of note issues; to the socialists by seeking to place the management of the most important private business of the country in the hands of the government; it seeks the support of bankers in great centers by its unexpected discrimination in their favor, but its dangerous doctrines and unwise methods do not appeal to the sound judgment of the American people. The bill as it stands with its partly ineffective and partly dangerous provisions would be detrimental to the interests of banks, with the exception, perhaps, of the great banks in the central reserve cities. Its objectionable features have neither the support of public opinion nor the approval of the banking fraternity. They are contrary to the teachings of political economists and they are not supported by the judgment of practical men. Its immediate enactment is urged by its sponsors upon the plea that it will create confidence and furnish remedies. It just falls short in its beneficial features of accomplishing a wise purpose and by the radical character of its objectionable provisions it threatens to upset business and to produce the evil results which it was projected to cure. Its authors have not ignored the lessons of exper-

*Geo. Tucker, Theory of Money and Banks Investigated, pp. 266-8.

ience, but are apparently afraid to make their legislation conform to its teachings, on account of the declaration of a party platform.

For centuries the world has witnessed recurring waves of popular delusion with reference to the magical power of paper money and the belief that wealth could be created by the stamp of the government upon pieces of paper. The losses occasioned by the folly of one generation have not deterred their successors from trying the same experiment and with the same results. It is, however, a source of satisfaction to the philosophic student of history to realize that no matter how severe the attack of monetary mania may be, sooner or later sanity will return and intelligence regain its control. We should keep in mind that any departure from sound economic principles will surely invite new disaster. There can be no permanent and satisfactory solution of this great problem so fraught with momentous consequences, until the American people shall be satisfied, after careful investigation or experience, that any plan proposed or adopted will surely respond to their reasonable demands for banking and monetary reform. Questions of this character cannot be finally settled by the majority of a party caucus or by the mere force of executive dictation. There are much broader questions involved than how best to secure an advantage to a political party. Any attempt to construct a plan for monetary reform upon a basis of sectional or political prejudices must fail. The enactment of legislation having this basis will raise an issue that will surely overshadow every other in future political contests.

No large part of the American people had any idea that the election of 1912 involved a reopening on the part of Mr. Bryan and his friends of the controversies of the past and an endeavor to secure, by partisan legislation, the triumph of the doctrines and

principles which had received the repeated condemnation of the American people at the polls. This should be a fight in the open. The party in power has no accredited mission to reverse these repeated judgments and to fly in the face of the concurrent judgment of the people of every commercial nation, based on universal experience.

Unless the teachings of an unbroken line of great statesmen are to be ignored, the features of this bill that I have discussed must be rejected. The administration that should force upon the American people by arbitrary methods an unwise solution of this problem will merit and sooner or later receive the condemnation of thoughtful men of all political parties.

It is the irony of fate that in a measure whose sole purpose should be to give strength and stability to our banking institutions and to furnish the people with a currency whose value could never be questioned that it should be found necessary to sacrifice the principles of a great party and to make the national banks the unwilling instrument in the work of their own destruction in order that Mr. Bryan may proclaim to the world a triumph of transcendant importance for his monetary and governmental theories.

Let us hope that the sober second thought of the national legislature may lead it to reject false doctrines and with a patriotic spirit to construct a plan of banking reform which is worthy the intelligence of a great people and which will serve their highest interests.